

DG 04-156

CONCORD STEAM CORPORATION

Notice of Intent to File Rate Schedules

Order Approving Permanent Rates

ORDER NO. 24,472

June 2, 2005

APPEARANCES: McLane, Graf, Raulerson and Middleton by Sarah B. Knowlton, Esq., for Concord Steam Corporation, and Edward N. Damon, Esq. for the Staff of the New Hampshire Public Utilities Commission.

I. PROCEDURAL HISTORY

On September 10, 2004, Concord Steam Corporation (Concord Steam) filed with the New Hampshire Public Utilities Commission (Commission) a notice of intent to file rate schedules. On November 1, 2004, Concord Steam filed its proposed rate schedules, pre-filed testimony of Peter G. Bloomfield and materials supporting a permanent base rate increase (Rate Filing). The Rate Filing requested an annual revenue increase of \$292,451, which represented a 6.4 percent increase over weather-normalized pro forma test year revenues. Also included in the Rate Filing was a petition for temporary rates in the same amount proposed for Concord Steam's permanent rates together with pre-filed testimony of Peter G. Bloomfield and supporting materials. The petition requested that temporary rates be effective pending the Commission's final decision on new permanent rates.

By Order No. 24,400 (November 16, 2004) the Commission suspended the proposed revisions to the permanent rate tariffs pursuant to RSA 378:6, pending investigation and decision thereon; scheduled a hearing for December 2, 2004, to address procedural matters regarding the proposed temporary and permanent rate increases; established a procedural schedule for temporary rates; and ordered Concord

Steam to publish notice of the hearing and notify all of its customers by sending them a copy of the Commission's Order of Notice. In addition, the Commission required it to serve a copy of the Order of Notice on the Concord City Clerk. Concord Steam duly noticed the temporary rate hearing by complying with these requirements.

In accordance with the Commission's Order of Notice, a prehearing conference was held on December 2, 2004. A technical session was held subsequent to the hearing and the parties agreed upon a proposed procedural schedule to govern the remainder of the proceeding which was filed with the Commission on December 6, 2004 by Secretarial Letter dated December 7, 2004, the Commission approved the proposed procedural schedule. On December 10, 2004, Commission Staff (Staff) filed the testimony of James J. Cunningham Jr., Utility Analyst III, on the request for temporary rates. On December 15, 2004, a hearing was held on temporary rates before Amy Ignatius, Hearings Examiner. On December 23, 2004, the Hearings Examiner filed her report with the Commission, recommending approval of the temporary rate request.

By Order No. 24,421 (January 7, 2005), the Commission granted the request for temporary rates, increasing annual operating revenue by 6.4%, effective January 1, 2005, on a service-rendered basis. On January 24, 2005, Concord Steam filed with the Commission a temporary rate tariff pursuant to Order No. 24,421. On February 22, 2005, Staff requested an extension of time to file its testimony until March 9, 2005, which the Commission granted.

On March 9, 2005, Staff filed the testimony of Mr. Cunningham on issues raised by the Rate Filing, including the amount of the requested permanent base rate increase, the extension of the lease with the State of New Hampshire, and the proposal to combine Concord Steam's unregulated Cogeneration Division with its regulated steam operations. On May 3, 2005, Staff submitted a

Settlement Agreement between Concord Steam and itself and the following day, the Commission heard evidence on the Settlement Agreement.

II. POSITIONS OF THE PARTIES AND STAFF

A. Concord Steam Corporation

Concord Steam states that it filed for a base rate increase because it has earned substantially less than its authorized rates of return during the past two years;¹ instead, it has been earning a rate of return of approximately one percent since 2002. For the test year ended December 31, 2003, it reported net operating income of approximately \$25,000, which translates to an actual overall rate of return of 0.65 percent.

Concord Steam modified its 2003 test year for certain proforma adjustments. In addition, it proposes to transfer the assets and retained earnings of the Cogeneration Division² to the Steam Division's accounts such that all the assets would be regulated by the Commission under N.H. Code Admin. Rules Puc 1100 and that, after the transfer, the Cogeneration Division would effectively cease to exist. Concord Steam asks that the Commission discontinue the application of the cost allocation agreement contained in the stipulation approved by the Commission in *Concord Steam Corporation*, 69 NH PUC 610 (1984) as this allocation agreement is no longer pertinent given the proposal to combine the two divisions.

Concord Steam also requests recovery of certain sewer charges associated with the discharge of steam condensate by its customers into the City of Concord's sewer system and, in turn, for recovery of such costs from its customers. Concord Steam will seek such a step

¹ Pursuant to an approved settlement, the Commission allowed Concord Steam an overall rate of return of 8.0 percent, including a return on equity of 8.45 percent. See *Concord Steam Corporation*, 88 NH PUC 157 (2003).

² In the pre-filed testimony of Mr. Bloomfield, he states that "the Cogeneration Division was formed in 1983 in order for Concord Steam to generate and sell electricity as a Small Power Producer. The Commission approved the Company's Small Power Producer rate order in DR 82-63." Exhibit 7, page 8, lines 15-18.

increase once it files with the Commission a fully executed copy of an agreement with the City of Concord regarding billing for the discharge for steam condensate.³

Concord Steam's proposal transfers the recovery of certain wood burning costs from the cost of energy rate to base rates. In the past, the Commission allowed recovery of the wood burning costs in its cost of energy. This was done to encourage greater use of wood in its fuel mix. However, in its most recent cost of energy filing, Concord Steam did not seek recovery of the wood burning costs, indicating instead that it would seek their recovery in this docket; the Commission, therefore, approved the cost of energy rate without the wood burning costs. *See Concord Steam Corporation*, Order No. 24,390 (October 29, 2004) in Docket No. DG 04-163.

At the hearing on May 4, 2005, Concord Steam provided an estimate of the bill impacts for different customer groups based on the Settlement Agreement.⁴ The total annual bill for a "small" customer, assuming annual usage of 95 thousand pounds (Mlbs) of steam and an energy charge at the current rate of \$10.88, would be \$2,182, a 7.63 percent increase over rates in effect prior to temporary rates. For a "medium" customer, assuming annual usage of 3,027 Mlbs, the annual bill would be \$69,457, a 7.62 percent increase. For a "large" customer, assuming annual usage of 7,350 Mlbs, the annual bill would be \$162,539, a 6.51 percent increase.⁵

Mr. Bloomfield also testified regarding interest in the Greenhouse Banking program operated by the New Hampshire Department of Environmental Services. This program allows credits for burning wood, which is considered a greenhouse neutral fuel.

Concord Steam advocates approval of the Settlement Agreement, which stipulates a permanent rate increase designed to yield an increase in annual revenues of \$292,451.

³ See Transcript of May 4, 2005 Hearing (Tr.), page 26.

⁴ Hearing Exhibit No. 10.

⁵ When measured against the *base rate portion* of the total bill, the percent increase is approximately 15.5 percent. For instance, the proposed *base rate* per Mlb for the first 500 Mlbs is \$12.11 per Mlb, an increase of \$1.63 per Mlb over the prior *base rate* of \$10.48 per Mlb, a 15.5 percent increase (*see* Rate Filing, page 4).

B. Staff

In its pre-filed testimony, Staff reported on its examination of the test year and proforma adjustments. These adjustments pertained to weather-normalizing sales, certain increases in wood-burning costs, costs and revenues related to the transfer of the Cogeneration Division, and general inflation impacts. Staff found that most of the proforma adjustments were appropriate and reasonable and incorporated such adjustments in its testimony.

Subsequently, Staff added several adjustments pertaining to rate base, rate of return and operation and maintenance (O&M) expenses. Also, Staff incorporated the adjustments recommended by the Audit Staff of the Commission. The Settlement Agreement reflects all these adjustments and Staff believes that the proposed revenue increase of \$292,451 is reasonable. Accordingly, Staff recommends that the Commission approve the Settlement Agreement.⁶

Staff's position is based on the assumption that the Commission will approve the transfer of the Cogeneration Division assets to the Steam Division accounts. The assets include the #6 boiler as well as the turbines and related ancillary equipment.⁷ Concord Steam proposes to transfer this property at its net book value of approximately \$600,000. By way of comparison, Staff notes that the estimated cost of new facilities is roughly \$6.0 million. Staff believes that the proposed transfer is reasonable and recommends Commission approval.

An issue related to the transfer of the Cogeneration assets is the cost allocation agreement. This agreement specifies how to allocate certain costs between the Cogeneration Division and the Steam Division. If the Commission approves the transfer of the Cogeneration

⁶ See Tr., page 12-20.

⁷ See Settlement Agreement, Exhibit S-2.

assets, there will only be one division; hence, the cost allocation agreement will no longer be applicable.

In addition to the capital cost of the Cogeneration facilities, Staff has reviewed the impact of the Cogeneration transfer as it pertains to O&M expenses of the combined entity. If the Commission approves the transfer of the Cogeneration assets, Staff estimates that the transfer will have a favorable effect on the Steam Division's O&M expense of approximately \$25,000, before taxes.⁸ Further, Staff has reviewed the turbine operations of the Cogeneration Division and has concluded that the plan to cogenerate electricity is sound, as benefits are expected to exceed costs.⁹

Staff notes that the impact of the transfer of the retained earnings of the Cogeneration Division increases the retained earnings of the combined entity. The higher equity level increases the weighting of equity in the capital structure for ratemaking purposes. This increase raises the percent of equity and consequently the overall rate of return.¹⁰

In addition, Staff reviewed the depreciation accrual rates for all plant accounts. Staff recommends that the average service life of certain plant accounts be extended as follows: structures should be extended by 15 years and the power plant should be extended by 5 years. This has the effect of reducing the depreciation accrual rates and related depreciation expense.¹¹

Staff calculates, based on the previous discussion, a revenue deficiency of \$314,583. However, Concord Steam explains that, in order to remain competitive with other energy sources, it is requesting an increase of only \$292,451. Staff recommends that the Commission approve the reduced amount of \$292,451.

⁸ Tr., page 20, line 10.

⁹ Settlement Agreement, Exhibit S-5.

¹⁰ Settlement Agreement, Exhibit S-3.

¹¹ Settlement Agreement, Exhibit S-4.

In addition, Staff also recommends that Concord Steam provide reports pertaining to: (1) status of the lease with the State of New Hampshire which is due to expire on August 31, 2010; (2) a report on the cost effectiveness of the turbine operations; and (3) monthly electricity sales.

III. TERMS OF SETTLEMENT AGREEMENT

The following discussion summarizes the signatories' agreements relating to the request for an increase in permanent rates:

A. Revenue Deficiency

The signatories agree that the annual revenue requirement, based upon the test year ended December 31, 2003, shall be \$4,800,234 , which is \$292,451, or 6.49 percent over test year revenues of \$4,507,783. The revenue deficiency in this proceeding shall be calculated using the following components:

Stipulated Rate Base: The pro forma rate base for the 2003 test year is \$3,538,184, as shown in Exhibit S-2.

Stipulated Adjusted Net Operating Income: The pro forma test year net operating income is \$96,490¹² as shown in Exhibit S-1.

Stipulated Rate of Return: The overall allowed rate of return shall be 8.02 percent, as set forth on Exhibit S-3.

Stipulated Revenue Deficiency: The stipulated revenue deficiency is \$292,451, as set forth on Exhibit S-1.

B. Depreciation Accrual

Effective January 1, 2005, Concord Steam agrees to accrue depreciation as set forth on Exhibit S-4. Specifically, it will keep depreciation accrual rates unchanged for all depreciable

¹² The Settlement Agreement incorporates the adjustments recommended in the Audit Staff's March 9, 2005 audit report. Concord Steam agrees with all of the findings in the audit report.

plant accounts except for power equipment and structures. For power equipment and structures, it will accrue depreciation at the rate of 3.04 percent and 1.93 percent, respectively.

C. Transfer Of Cogeneration Assets To Rate Base, Discontinuation Of Cost Allocation Order And Agreement To Use Staff Template To Determine Cost Effectiveness Of Cogeneration

In its Rate Filing, Concord Steam requested authorization from the Commission to include in its rate base assets that had been in use by its Cogeneration Division, which had not been subject to regulation by the Commission. These assets, which include the #6 boiler and related turbines, had previously been used, in part, to cogenerate electricity which was sold to Public Service Company of New Hampshire under a long-term rate order approved by the Commission. *See Concord Steam Corporation*, Order No. 17,330, 69 NH PUC 668 (1984) and Order No. 17,369, 69 NH PUC 695 (1984). Because the above market long-term rates expired on or about December 31, 2004, and were not subject to renewal, Concord Steam requested authority to (1) include the assets in rate base since they would be used, in part, to produce steam (i.e., the #6 boiler and accessory equipment) necessary for regulated steam utility operations and, in part, to cogenerate electricity for its own power plant needs and for sale through ISO-New England (i.e., turbines and accessory equipment)¹³ and (2) discontinue the allocation of costs to the Cogeneration Division.

After conducting a cost-benefit analysis of the proposed transfer, the signatories agree that the rate base should include all turbine and #6 boiler assets of the Cogeneration Division, as described on Schedule S-2. O&M and fuel costs associated with cogeneration should be included in the O&M and fuel costs as shown on Exhibit S-1 and S-5. In addition, the cost

¹³ In addition to cogenerating electricity for its own power plant needs, Concord Steam proposes to bid into the wholesale market any excess electricity, for which it would be paid the wholesale clearing price.

allocation agreement approved in Order No. 17,261 shall be discontinued effective January 1, 2005.

Beginning on September 15, 2005, and continuing each year thereafter, Concord Steam shall provide a report to the Commission in the form of Schedule S-5 summarizing the prior year actual¹⁴ and projected going-forward year cost effectiveness of running the turbines in the cogeneration of electricity. As long as the turbines are running to cogenerate electricity, within five business days of receipt of information from Unitil Energy Systems, Inc. regarding its monthly sales of electricity through ISO-New England, Concord Steam shall electronically file such information with the Commission's Gas/Water Division. It will inform the Gas/Water Division if it ceases to sell through ISO-New England for any time period of one month or longer.

D. Status Of Regulation Of Cogeneration Division

The Cogeneration Division has heretofore been operated on an unregulated basis.¹⁵ Under the Settlement Agreement, the retained earnings of the Cogeneration Division will be included in the accounts of the Steam Division, the assets of the Cogeneration Division will be added to its rate base, and certain of the costs and revenues associated with the Cogeneration Division will be taken into account in determining the revenue requirement. Accordingly, the steam rates will be based in part on cogeneration assets, costs and revenues.

According to the Settlement Agreement, the signatories agree that Concord Steam will be a steam utility, but not an electric utility. Further, they agree that the cogeneration operations are

¹⁴ The prior year actual amounts for the first year will be for the months of January 2005 through July 2005 only since the actual data for a full year will not be available at the time of the initial benefit/cost filing in September 2005.

¹⁵ A separate set of books and records has been maintained for the Cogeneration Division, separate and distinct from the books and records of the Steam Division. Concord Steam has filed reports on the operations of the Steam Division but has not been required to file reports on the operations of the Cogeneration Division.

integrally related and incidental to Concord Steam's provision of steam service; that under the Settlement Agreement the Cogeneration Division and the Steam Division will no longer be operated or maintained separately for any purpose (other than for determining the cost effectiveness of the cogeneration operations); and that the cogeneration operations, revenues obtained and expenses incurred in connection with those operations, will be subject to regulation by the Commission to the same extent as its steam service operations.

E. Lease With State of New Hampshire

The steam plant is operated on property that is owned by the State of New Hampshire and leased to Concord Steam. This lease is scheduled to expire on August 31, 2010. The Company has been actively seeking the renewal of the lease in order to obtain assurance that it can continue to operate the steam plant at its current location. To date, the State of New Hampshire has not committed to a new long term lease. Under the Settlement Agreement, Concord Steam agrees to file a report every 90 days updating the Commission on the status of its talks with the State to extend the lease.

In addition, the signatories agree that in the event that the lease with the State is not extended and Concord Steam cannot operate at its current location, the payments under a loan from Concord Steam to Mark Saltsman shall be accelerated consistent with the date on which the lease with the State is terminated.

F. Rate Design

The signatories agree to maintain Concord Steam's present rate design and, as stated in the Rate Filing, to recover the revenue increase resulting from this Settlement Agreement from all customers pro rata in accordance with such rate design.

G. Effective Date And Recoupment

The revised rates with regard to the test year data will be effective on a service rendered basis as of the date of Commission approval of the Agreement establishing permanent rates. Concord Steam will be allowed to recoup its reasonable rate case expenses as approved by the Commission through a surcharge applied over twelve months, to commence upon approval of such expenses. Concord Steam shall make such a filing no later than ninety 90 days from Commission approval of the Settlement Agreement. Such request shall set forth a detailed itemization of such expenses. Rate case expenses shall include the legal expenses directly related to this docket and such other expenses directly related to this docket as may be allowed by the Commission.

H. Sewer Charges

The signatories agree that Concord Steam may obtain a step increase in its base rates to allow it to pay the City of Concord the costs associated with the discharge of steam condensate by its customers into the City's sewer system and, in turn, for recovery of such costs from its customers. Concord Steam may request such a step increase once it has filed with the Commission a fully executed copy of an agreement with the City of Concord regarding billing for the discharge for steam condensate.

I. Management Contract

Within thirty days of the approval of the Settlement Agreement by the Commission, Concord Steam will file with the Commission, pursuant to RSA 366:3, a revised management contract between Concord Steam and Bloomfield Associates, P.A. which shall specify the particular services to be provided by Bloomfield Associates. The signatories agree that the \$72,000 management fee paid pursuant to the existing contract between Concord Steam and

Bloomfield Associates in connection with the 2003 test year is reasonable. In the event Concord Steam amends the management contract, it agrees to comply in all respects with RSA 366:3.

IV. COMMISSION ANALYSIS

We have carefully reviewed the record in this docket, including the Settlement Agreement and supporting testimony presented at the May 4, 2005 hearing, and we find that the terms of the Settlement Agreement are reasonable and in the public good. In addition, we find that its terms will result in just and reasonable rates and they represent an acceptable resolution of ratepayer and utility interests under current economic circumstances.

The requested revenue increase of \$292,451 results in an overall rate of return of 7.64 percent, which is less than Staff's recommended overall rate of return of 8.02 percent. Nevertheless, the revenue increase is designed to cover operating costs as well as provide an acceptable rate of return while maintaining a competitive rate with the alternative energy sources available in the Concord area.

The Settlement Agreement provides for the transfer of the Cogeneration Division assets to the Steam Division's accounts, and thus to be included in Concord Steam's rate base, in order to reflect their use in the production of steam for Steam Division customers and the continued cogeneration of electricity. We find that this transfer is in the best interest of Concord Steam's customers for a number of reasons.

The existing Cogeneration assets include the #6 boiler and the turbines. The #6 boiler is in place and currently provides approximately 80 percent to 90 percent of the plant production and is available for immediate use by the Steam Division customers. The net book value of the

existing assets is approximately \$600,000.¹⁶ Concord Steam contends that it would incur original costs for new equipment that is estimated to be roughly \$6 million. Significant costs are avoided by transferring the existing equipment at its net book value, as depreciation and return on existing plant will be significantly lower than they would be if new equipment had to be purchased. Also, since the existing plant is being transferred at net book value, there is no interest cost related to finance charges to be passed along to customers. In addition, we find that the transfer of the turbines provides an added benefit by lowering the Steam Division's O&M expenses. Since the turbines can be run in a cost effective manner at this time,¹⁷ the Steam Division can save electricity costs by self-generating most of its own electricity needs and it can generate additional revenue by selling the excess power through ISO-New England. Consequently, we find the transfer of the Cogeneration assets to be reasonable and their inclusion in rate base to be appropriate.

Regarding the status of regulation of the Cogeneration Division, the assets and retained earnings of the unregulated Cogeneration Division are being included in the accounts of the Steam Division. Concord Steam will not be deemed to be an electric utility; however, it will be subject to regulation by the Commission to the same extent as the steam service operations. Also, since the Cogeneration Division ceases to exist as a separate entity for accounting purposes, there is no longer a need for the cost allocation agreement that allocates costs to separate divisions.

We find that the various reports specified in the Settlement Agreement are appropriate; particularly, we find the quarterly lease status report will be helpful in monitoring the status of

¹⁶ Settlement Agreement, Exhibit S-2. The transfer includes components as follows: Total Plant-in-Service, Accumulated Depreciation, Materials and Supplies, Cash Working Capital, Customer Deposits, Contributions in Aid of Construction and Deferred Federal Income Taxes.

¹⁷ Settlement Agreement, Exhibit S-5. The cost effectiveness test is updated for the Commission on an annual basis.

the lease which is due to expire on August 31, 2010. The annual report on the cost effectiveness of running the turbines is expected to be instructive, and it is our understanding that this report will be filed along with the annual cost of energy filing, on or near September 15th of each year. Also, we note that, within thirty days, Concord Steam will file a revised management contract with Bloomfield Associates, pursuant to RSA 366:3

Another consideration in this case pertains to the new billing arrangements that the City of Concord and Concord Steam are in the process of finalizing. According to testimony at hearing, steam customers, who are also sewer service customers of the City of Concord, are getting two bills from the City of Concord: one for their regular sewer discharge, and a second bill for the discharge of the steam condensate into the sewer system. Customer confusion should be lessened with the elimination of the extra sewer bill. In addition, the customer's overall cost of steam service will remain unchanged under this proposal, while the City of Concord will benefit from reduced billing costs without an increase in Concord Steam's billing cost. The Commission understands that when Concord Steam reaches a definitive agreement with the City, it may request the Commission to grant a "step increase" in base rates. We believe that a "step increase" as reflected in the Settlement Agreement is an appropriate mechanism to recover such costs.¹⁸

Because there is no difference between the temporary rates and the permanent rates, there is no need to require a surcharge to recoup any deficit or refund any excess. However, the Settlement Agreement does provide for a recoupment of reasonable rate case expenses through a surcharge applied over twelve months. We believe that the proposal surcharge recovery mechanism, subject to audit, is a reasonable mechanism.

¹⁸ Concord Steam estimates that this cost is roughly \$80,000 (Tr., page 27, line 19).

Based upon the foregoing, it is hereby

ORDERED, the Settlement Agreement entered into between Concord Steam Corporation and Staff is APPROVED; and it is

FURTHER ORDERED, that Concord Steam Corporation shall file properly annotated tariff pages in compliance with this Order no later than 15 days from the issuance of this Order, as required by N.H. Code Admin. Rules Puc 1603.

By Order of the Public Utilities Commission of New Hampshire this second day of June, 2005.

Thomas B. Getz
Chairman

Graham J. Morrison
Commissioner

Michael D. Harrington
Commissioner

Attested by:

Debra A. Howland
Executive Director & Secretary